UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Adversary 08-01789-brl

- x

In the Matter of:

SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiff

v.

BERNARD L. MADOFF INVESTMENT SECURITIES, LLC, et al

Defendant

- x

In Re:

BERNARD L. MADOFF INVESTMENT SECURITIES, LLC, et al

Debtor

- x

U.S. Bankruptcy Court

One Bowling Green

New York, New York

September 10, 2013

10:03 AM

B E F O R E :

HON BURTON R. LIFLAND

U.S. BANKRUPTCY JUDGE

Hearing re: (cc-5038-5041) Trustees Motion for an Order Affirming Trustees Calculations of Net Equity and Denying Time-Based Damages

Transcribed by: Jamie Gallagher, Melissa Looney, Penny Skaw

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P R O C E E D I N G S

THE CLERK: SIPC v. BLMIS.

THE COURT: We have appearances for the (indiscernible - 00:01:35)?

MR. SHEEHAN: Yes, Your Honor. David Sheehan with Baker Hostetler, attorney for the trustee, Irving Picard.

MS. WANG: Josephine Wang for the Securities Investor Protection Corporation.

MR. SCHWED: Greg Schwed of Loeb & Loeb for various customers.

MR. KIRBY: Richard Kirby, K&L Gates for various customers.

MR. AVERY: I'm John Avery, representing the Securities and Exchange Commission.

MR. BESIKOF: Dan Besikof with Loeb & Loeb for various customers.

MS. HARRIS: Marcy Harris with Schulte, Roth, and Zabel, HHI (indiscernible - 00:02:07) trust.

MS. YOUNG: Jennifer Young from Milberg LLP for various customers.

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MR. LINDSAY: Scott Lindsay from K&L Gates, various customers.

MR. WARMUTH: Glen Warmuth, Stim & Warmuth for

Michael (indiscernible - 00:02:23).

THE COURT: It's your motion, Mr. Sheehan.

MR. SHEEHAN: Yes, Your Honor. I understand.

I think there's a couple of actually -- perhaps, housekeeping items that I would suggest with Your Honor's permission we could address.

One is, is that Judge Grasay (ph), as I'm sure Your Honor is aware, ruled last week with regard to the intervener's appeal. That appeal was denied. That leaves the other half of that, which we already have argued before Your Honor previously and have submitted briefs on.

I don't intend to argue that here this morning and that is that those people who filed the claim, but did not object to the determination should also not participate in this proceeding for all of the reasons we stated earlier. I don't mean to go into that again today. So, I just wanted to put that to the side.

The other thing is, is that we have raised an objection here with regard to Mr. Hart (ph) testifying. And what I thought we could do is perhaps deal with that issue, at least our objection now, because if Your Honor is inclined to hear his testimony, that would, I would think, go before any argument by us.

Our position is well stated in our briefs, but I think it's even better stated, if I may be so bold, as to

refer to the brief filed by our adversaries who give us the three reasons why they think Mr. Hart could be of assistance to Your Honor here this morning.

The three things they say he's going to address are, and I'm quoting from page 1 of their brief, one, that well established and uncontested principle of the time value of money. Something I think Your Honor needs no assistance whatsoever to understand, or to apply, or determine in this case.

Number two, the application of that principle to the customer claims. Again, a rudimentary application of a time honored principal. Again, something I don't think Your Honor needs any assistance on.

And last, but not least, the purported burden, that is the burden of applying that principle to all of the claims that the trustee has had filed with him. Again, not something that we've -- given all of Your Honor's experience and background that you would need any assistance to reach any of the determinations here.

But last, but not least, and perhaps most importantly, that none of these factual issues that are being raised here have anything to do with the ultimate legal principal, whether or not interest or the time value of money is something that is afforded to customers in their customer claim.

And we believe, obviously, that should be decided on the law based on the statute and the decisional law that we've cited to Your Honor, and therefore, Mr. Hart should not testify here this morning.

MR. KIRBY: Your Honor, Richard Kirby on behalf of customers.

I think to understand why it is appropriate to have an expert witness, we go to the -- or a witness with respect to this issue, we have to go to the position of the SEC in this matter, which has stated that -- that, and you will hear from Mr. Avery later today, that one of the fundamental questions in deciding the issue of whether there should be an inflation adjustment in the net equity determination is that you must determine the question of the administrative burden.

THE COURT: A cost benefit analysis?

MR. KIRBY: A cost benefit analysis, that is fundamentally a fact issue. The trustee has put in issue that fact question by putting on a declaration -- filing a declaration by their witness, Mr. Rock (ph).

Subsequently, Your Honor, we were issued a scheduling order authorizing the customers to have a rebuttal witness. That witness is Mr. Hart. Mr. Hart testifies about what I think is a mixed question of law and fact as to the effective inflation.

Mr. Hart would testify as a second issue as -- which will amplify on something that Mr. Rock stated, and we put it forth in evidence through his deposition testimony because Mr. Rock is not here, as to the impact. And the most important issue is Mr. Hart's experience and specialized knowledge with respect to the question of administrative cost in administering an estate like this.

He has substantial experience administering much larger estates than this, and he is prepared to testify about how having reviewed the database of the trustee and reviewed the information that the trustee has provided about the -- his claim calculations, how simple it would be to implement an inflation adjustment should the Court determine that.

And because that is a fundamental issue of fact that the Court must decide, it's not a legal question, it's a fact question, we think that the Court should have a -- the opportunity to hear the witness.

As far as the question of exclusion, he -- under Rule 702, as we've stated in our papers, but the standard is one of specialized knowledge. He clearly has that. Once you hear his background and experience, you will be most impressed about the large experience he's had administering and being involved in the administration of large insolvencies, much larger than this one. And based upon

that knowledge, he can provide testimony that will assist you, as trier of fact, on several of the issues that you need to decide.

One of the issues that you will have to decide is, is the SEC -- is the ultimate question of what the SEC attributable state, which is that the difference between -- which is -- the Court can certainly take judicial notice. We ask the Court to take judicial notice of -- in the papers, but it is a question of what is the impact of inflation and the importance of that in determining -- in a cash in, cash out method under the facts like this.

The second thing is the impact of the various inflation adjustments and how it would impact the estate overall, which is an important consideration in determining administrative burden.

And the third issue that the Court will need to address is the fundamental question of what is it going to cost, and how much time would it take. And Mr. Hart can assist the Court on each of those.

We think that meets the criteria for Rule 702, and therefore we ask --

THE COURT: All of this is captured in this binder you submitted to me?

MR. KIRBY: That's -- those -- that is not all captured in that, okay? That is -- that is material that

comes from Mr. Rock --

THE COURT: But his declaration would capture everything that you're telling me?

MR. KIRBY: In his -- his -- his testimony and his written report would -- would -- that he -- he submitted an expert report that is permitted under the rules --

THE COURT: Very well.

MR. KIRBY: -- and he -- it will be within that.

But I think it would be helpful to the Court, that's the reason we brought him here today -- it would be helpful to the Court to understand the -- from somebody from his experience the -- you know, how that -- how to administer something of that -- which the trustee has stated is tremendously burdensome.

THE COURT: Thank you. Anyone else want to be heard?

Mr. Sheehan, any response? Or should I take your opening statement as your response?

MR. SHEEHAN: Well, my response would be that I think we're putting the cart before the horse here. Even the SEC's cost benefit analysis is a cart before the horse. Your Honor refers to all --

THE COURT: Well, the SEC takes the position that it's a discretionary matter now for me and I should do a cost benefit analysis before I exercise my discretion.

I thank you, Mr. Sheehan, and I thank the others. And I also thank everybody for the enormous amount of work that's gone in to get us to today.

The briefing has been excellent and it's come from every quadrant of the bar, and all of the main interests that are swept up in the Madoff affair. But I have to agree with Mr. Sheehan that this is essentially a matter of law, and it is not going to turn on a question of fact. I've analyzed all the briefs.

However, in order to preserve a record for everyone, and since both sides have submitted their version of what would be involved in a cost benefit analysis, I have all of the so-called tendered exhibits. And notwithstanding the fact that the Court has some serious concerns and (indiscernible - 00:12:01) as to the ultimate admissibility of some of the expert testimony, I'm certainly willing to make as part of the record the submission that's essentially the Hart, the Seagel (ph), and Rock, both depositions and declarations that have been placed before the Court, and those documents that are sought to be submitted in support of them. So, that will all be part of a record.

However, if -- to have a recorded testimony, it's not necessary and again I'll reiterate, I certainly find that this issue is resolvable as a matter of law.

Go ahead, Mr. Sheehan.

MR. SHEEHAN: Thank you, Your Honor.

Your Honor, as I was preparing this here today, I know Your Honor reads all the papers, and I know you're very familiar with it. So, I just want to try to offer you --

THE COURT: I wore out a pair of glasses.

MR. SHEEHAN: I can totally understand that.

THE COURT: Actually, I lost my glasses yesterday and I was afraid I'd have to adjourn the hearing.

MR. SHEEHAN: Oh my goodness, wow. Well, I'm glad you found them.

The -- I'm trying to offer you a perspective, then, that, you know, underscored by what's in the briefs, but perhaps a little bit different.

And in doing so, I go all the way back to when I was here a few years ago arguing at this very podium the net equity decision. And at the very end of that argument, I got up and I said to Your Honor, there's only one thing that's certain if in fact you rule in favor of my adversaries with regard to the (indiscernible - 00:13:32) method. And that is, is that people who did not get all their money back will get less. And the people who got other people's money will get more. And the same principle adheres today.

This is, after all, and I know people don't want to hear this, it's a Ponzi scheme. It's a zero sum gain.

There's only one pot of money. Until everyone who lost all of their money is fully satisfied, there's nothing that should provide for other people getting their money. That should not happen.

And so with that principle in mind, let's take a hard look at what we're really talking about here because it gets lost, I think, in all of the rhetoric of all of our papers, and that's this.

What is SIPA really all about? It's all about a priority for customers so they get their cash and their securities back. It recognizes that when you have a customer account, you are at risk. You may very well lose everything by your investment. You could pick Float to Relax, Inc. and it just doesn't take off. Many, many things can happen to that account.

So, SIPA never guarantees that you'll get a return. SIPA never suggests that if there's fraud, that you somehow get damages. None of that is the case. It's simply this. If you have cash and stock there on the filing date, you're entitled to get that cash and stock back, up to limits of protection and whatever the customer fund, assembled by the trustee, can distribute to you. That's it.

There is nothing else in net equity, and that is the fundamental principal upon which the net equity decision that Your Honor rendered, and affirmed by the Second

Circuit, is predicated upon, that that's what they get. They don't get anything else.

So, to suggest here that because, yes, it is a horrible situation, no one in this courtroom certainly starting with the trustee on down to his entire staff, does not recognize the pain that's been inflicted by Mr. Madoff on all of the net winners in this case.

They are, in fact, people who suffered. They looked at their statement and thought they had an investment which they did not have. They thought they were actually getting profits which weren't real. They had to return them. They're being sued for those. We understand that, but that is the nature of a bankruptcy proceeding. That is the nature of a SIPA proceeding, that a trustee assembles that customer property and redistributes it.

There is nothing, absolutely nothing in the statute that's been pointed to by either the SEC or any of our adversaries that suggests that interest, or an inflation adjustment, or whatever name you wish to call it is available to a customer claimant.

Let's just pause on that. Customer claimant. That's what we're focusing on here. It's not a question of whether or not somewhere within the context of this overall massive proceeding that at some point down the road -- let's assume that Mr. Picard has the success that we're striving

for and that we, indeed, attain all of the money back. And along with the statutory mandate of, you know, reimbursing SIPA, and doing all of those other things, there's a general estate.

If there is a general estate, what is interest? It's damages. It's clearly associated with the general creditor claim.

So, we're not saying that someone can't come in here and say, my goodness, I gave Mr. Madoff, that thief, my money and look what he did with it. I should get a judgment against him as a tortfeasor. And I should be able to prove that claim as a general creditor claim, because the trustee has now assembled a general estate.

That's not what we're talking about here. They're trying to take those principals and somehow infuse them into a statutory mandate that Congress has created that has a very limited, albeit a very salutary purpose, but a very limited role and that is to give you back your stock and your cash. To try and infuse in that the concept that there is a inflation adjustment that should be available is just wrong.

With respect, the SEC has corrupted new times when it suggests to Your Honor, now wait a minute, legitimate expectations have a role here. So, anyone who gave somebody money and then left it there for a couple years has a

legitimate expectation that at the end of the day they shouldn't just get that money back, they should get something on top of that.

Where is that expectation emanate from? It cannot emanate from the fact that they gave money to the broker and think that somehow they're going to get interest on it.

If Your Honor gave $1,000 to Merrill Lynch and did nothing with it and ten years later went to Merrill Lynch and said I want my $1,000 plus interest, they'd be dumbfounded. You would not be getting any interest because you would not be entitled to it.

So, if that's the case, in the ordinary day of commerce that we have in the brokerage industry, how can it be true that in a filing, when you have a complete debacle like we have here, that somehow we engraft upon it an expectation that somehow the brokerage account became something different. It became an FDIC account? It became a note with interest? It became some other legal vehicle that gives you the ability to get time value of money? That's just not true.

THE COURT: Well, it could have contractually, but I don't see that contractually that existed here.

MR. SHEEHAN: Absolutely, Your Honor. And there are cases. And they're cited by our adversaries. And we acknowledge the fact that in those cases where there's a

contractual obligation to provide interest, Corolla Zella (ph), and all those other cases, we agree. But there is no such contractual obligation here. There's no statutory requirement for it. There is just simply nothing in the record to support this.

So, at the end of the day, while we understand why our adversary suggests, well look, it's fair. It's just fair. Well, with all due respect, fair isn't what is in play today. What's in play here today is the statute itself and the law, and what the law requires.

And while we may feel as though there's something we want to do here, when the SEC suggests there should be maybe something here, I think they're wrong. And I think the Second Circuit gave us really good insight into this in the Walsh decision, which I know Your Honor's familiar with, which the SEC and the CFTC participated in and submitted.

And it's quoted at length in the opinion by the Circuit, submitted that when the trustee, in that case a receiver, has assembled a rarely massive estate, what should happen in that instance is there should be no interest associated with the Ponzi scheme as there was in that case, because it would be wrong. That's what they said, wrong, to take the money from those people who did not get their principal back and give it to other people who already got their principal and fictitious profits. It would be wrong.

I submit to Your Honor it would be equally wrong here. The same principles that applied there, apply here today. And I would submit to Your Honor that based on the record that we have before you, that interest inflation adjustment, whatever it should be, should not be afforded to the customer claimants here, and it should be denied.

Thank you, Your Honor.

MS. WANG: Josephine Wang for the Securities Investor Protection Corporation. Good morning, Your Honor.

THE COURT: Good morning, Ms. Wang.

MS. WANG: SIPC supports the position of the trustee in this matter. We must respectfully disagree with our colleagues from the SEC.

There is no statutory authority or any other basis to impose an inflation, or any other time based damages in this case, inflation factor.

Now, it’s true that in SIPA there is an inflation provision, at least since 2010, but that relates to the adjustment of the amount of cash that SIPC can advance for cash claims. So, up until 2010, SIPC could advance up to $100,000 to satisfy claim for cash.

Since 2010, that amount has become $250,000 subject to a possible adjustment for inflation. But even providing -- even in providing for that possible adjustment, Congress imposed several conditions. First of all, every

five years, SIPC has to --

THE COURT: Those conditions are rather daunting as I read the statute.

MS. WANG: Absolutely, Your Honor. And I'll be happy not to review them if they are simply repeating the conditions for the Court. But they are very onerous.

And so Congress did not intend that simply on a whim, amounts be adjusted for inflation. There were many conditions that have to be met; notice of any adjustment for inflation has to be published. You give the public an opportunity to comment. SIPC reports to the Congress. It's not simply something that's done overnight. It's a very well considered action.

But that's not what's being done here. What's being done here is simply because the SEC has suggestion that possibly -- just possibly there should be an adjustment for inflation, that should be the case, but that's not the rule of law. That's not what Congress has provided.

And in fact, that would be changing the definition of net equity, which is something that is specifically prohibited under SIPA Section 78 CCC B4A.

There are other reasons why the adjustment is inappropriate in this case. One is that realistically what's being looked for here are damages. What you get in a SIPA proceeding, is what you have deposited with the broker.

If you give the broker $100, that's what you get back. If you're looking for something more, because you were damaged, because the broker lied to you, that's a claim you may have, but you have it as a -- you have it as a general creditor, not as a customer.

And certainly the intent of SIPA was not for the customer to do better in liquidation than he would have done otherwise, but that's exactly what these customers are looking for at this point, at this time. When an investor suggests that he should get 9 percent interest on the amount that he deposited with the broker, that's not a SIPA protected claim. That's allowing the investor to do better in bankruptcy than he would have done in the marketplace.

And so for these reasons, because there is no statutory authority, because there is no basis to apply an inflation or any other adjustment, such as interest, we would ask that the Court grant the trustee's motions and affirm his determinations of these claims. Thank you, Your Honor.

THE COURT: Thank you. Does the SEC want to be heard from?

MR. AVERY: You want to hear from us next?

THE COURT: It seems we ought to lump the Government together, even though they might be on opposite ends of the argument today.

MR. AVERY: Might as well. My name is John Avery. I represent the Securities and Exchange Commission. SIPC just said the way the statute works is if you give the broker $100, that's what you get back.

That would certainly be true if you had a claim for cash. Here the customers have claims for securities and it seems to me that those securities have to be valued, which is a bit of a task, because they -- as we all know, they are fictitious securities or at least fictitious security positions. Nevertheless, they are claims for securities and the question is how best to value them.

Now, the trustee came up with the net investment method, cash in, cash out. And that's a method that the SEC vigorously supported, but with the caveat that when you're valuing the net investment, it may make sense to make an adjustment to account for interest so as to best value the money when it went in and value the money that came out when it came out.

We think this will provide for a more accurate valuation of the customer's net equity, the customer's claims for securities.

THE COURT: That's not the position you took in Walsh (ph); is that correct? And Walsh was also a long standing Ponzi scheme lasting over 13 years or even longer.

MR. AVERY: Different circumstances, Your Honor.

I wasn't involved in the Walsh case, at least not that aspect --

THE COURT: But the SEC was.

MR. AVERY: -- not that aspect of it. The SEC was.

THE COURT: This is not a personal situation, this is a position taken by a Government agency. And, you know, there's a deference standard that the Court has to look to.

MR. AVERY: Well, let me address that just very briefly. We're actually not asking for deference here. If we were asking for deference --

THE COURT: Not even --

MR. AVERY: If we were asking -- it would be --

THE COURT: Not even Skidmore deference?

MR. AVERY: -- it would be Skidmore deference, which means if what I'm saying makes sense to you --

THE COURT: So you cross your fingers and hope I give it to you?

MR. AVERY: Pretty much. Pretty much, Your Honor.

THE COURT: Oh, I get it.

MR. AVERY: But we -- we're not claiming Chevron deference. We acknowledge that this is a position that we're taking in this litigation and as you pointed out, a different position was taken in the Walsh case.

Let me just address a couple of the points that

the trustee makes. Because I do think that contrary to the trustee's argument, that the statute is clear and that you've got no discretion to make an adjustment, assuming you want to, then that's nonsense. The trustee says there's no specific in SIPC that would allow for any sort of an adjustment for inflation. Well, there's nothing specific in SIPC that requires cash in/cash out. It's a method for determining in this unusual circumstance what the value of the claim for securities is.

In fact, the Second Circuit made it perfectly clear. It says, the statute does not say specifically how net equity should be calculated. If a just honest broker failed to place a customer's funds into the securities market, notwithstanding the customer deposited cash with the debtor for the purpose of purchasing securities.

The Court went on to say, that differing fact patterns will inevitably call for differing approaches to ascertaining the fairest method for approximating net equity as defined in SIPA. Well, how are we going to do that as -- it's the Commission's position that given the length of the fraud here, you'll get a better view of the customer's investment -- customer's net investment by making an adjustment for inflation. This is completely different from an adjustment for interest.

One of the things the trustee has done is tended

to confuse an inflation adjustment, interest, a claim for damages. In fact, he lumps them all under the rubric of time based damages. Well, I would submit that an inflation adjustment is neither interest nor damages. It simply recognizes the value of the money at the time it went in and the value of the money at the time it came out.

Finally, I would just say perhaps I've already said it, that the trustee's position would be entirely appropriate if these were claims for cash. If the customer put cash in, didn't expect to receive securities back and later the broker went belly up, the customer would expect to get his cash back without interest, without an inflation adjustment, without any damages. But again, I submit that here you've got to value the securities.

It is the Commission's position, as the trustee points out, that the statute doesn't require you to make an adjustment. The Commission believes that it's a question of whether it's -- whether it makes sense in this case, whether the value of doing so outweighs the obvious burdens.

Any questions?

THE COURT: Thank you.

MR. AVERY: Thank you.

MR. SCHWED: Good morning, Your Honor. Greg Schwed of Loeb and Loeb.

THE COURT: Good morning, Mr. Schwed.

MR. SCHWED: Good morning. We represent numerous clients and we are also speaking on behalf of the seven law firms that signed on to the consolidated brief. In an effort to spare Your Honor the burden of multiple and duplicative filings, our goal was to try to pool our efforts into one brief.

There have been other customers who have filed papers and just to clear up one confusion, the consolidated brief is not asking for 9 percent interest. That's -- there may be some others who are. It is not our position.

We support the SEC's position in this case and we think it really resolves to a very simple and fundamental issue that was framed in the net equity decision that SIPC and the trustee are so fond of citing.

In addition to the quotations that Mr. Avery made, the Second Circuit left in our view absolutely no question that the proper technique the proper procedure for assessing competing views is to actually look at them as competing views is to actually look at them as competing views.

And they even -- they even articulated a standards, which we admit gives the trustee a modicum of deference, but if the trustee's method as head to head against a competing method is clearly inferior to the competing method, then the competing method should prevail.

And we think it's really a red herring, just sort

of a preliminary road block that the trustee and SIPC are setting up and they do it skillfully as one would expect in saying that the statute, the SIPA statute itself just flatly bars anything other than their method. It's their way or the highway. It's either net investment method with no adjustment or as we're suggesting and the SEC is suggestion, the same net investment method, but with an adjustment to take account of economic reality and fairness.

And really that's what this case comes down to, we believe. And we actually agree with Your Honor. We -- our initial submission to the Court did not provide for a factual hearing. The SEC took the position that in principle it was fair to adjust for constant dollars and inflation, but said that they wanted a fuller record on it, and so we -- we engaged in some discovery and we're prepared to put Mr. Hart (ph) on if necessary.

But we do think that in fact, as a matter of law, this case can be decided. Hopefully when we think what your honor is thinking, but that's obviously one of the mysteries of the ages. The -- we think it can be decided as a matter of law, because the concept that a dollar today is not the same as a dollar 20 years ago is so incandescently obvious that it barely needs belaboring.

Your Honor made a very good -- had a good and detailed example in your opinion in the net equity decision

and we put an example in our brief as well, which we think really focuses the issue. It's not unrealistic. It subsumes the time frame we're talking about. We mention it in the first brief, which is ECF 5133. And I'll just -- with Your Honor's forbearance, I'll just go through it one more time, because it seems to us so clear that no one can really deny the fairness. And ultimately fairness goes back to Bank of Maron v. England that old case from 1966. The Bankruptcy Court is a court of equity. And it should be doing the right thing, unless of course it's constrained by a statutory command that goes the other direction.

And perhaps just to linger for a moment on whether the statute does in fact constrain Your Honor and force Your Honor to decide that only unadjusted net equity is the way to go. In addition to the quotations that Mr. Avery made, the Second Circuit made no doubt about it. I'm quoting now from 654 F.3d at 235. The statutory language does not prescribe a single means for calculating net equity that applies in the numerous circumstances that may arise in a SIPA liquidation.

If that weren't enough, the Court goes on to say at Footnote 5, the two competing methods of calculating net equity proposed by the parties to this litigation are the only two methods at issue here.

We do not hold that they are the only possible

approaches to calculation of net equity under SIPA, and yet Mr. Sheehan and Ms. Wang say, that really is -- it's their way or the highway. It's net adjustment, it's net equity, unadjusted or nothing.

Note 6, we express no view on whether the net investment method should be adjusted to account for inflation or interest.

So the Second Circuit was acknowledging what I think is clear from the statute, which is the statute itself, the SIPA statute doesn't deal with the Ponzi scheme. It's just so clear. They talk about yes, you're an investor, if your broker goes under, you're entitled to get your securities back. And that makes complete sense and you're entitled to have SIPA insurance to the extent that you have Exxon stock that was there. We'll give you the Exxon stock.

What do you do if that doesn't happen? If you've got a Ponzi scheme where he's not buying anything? And courts have had to engage their resourcefulness and their pragmatism to come up with a fair and appropriate result. That's never more evidenced than in the New Times Decision, another Second Circuit case that Your Honor is familiar with from about ten years ago.

And again, this was a Ponzi scheme; the net equity definition was in play. The whole question there was what

happens --is the investment made by the customer, is that a cash deposit entitled to only $100,000 of SIPA protection or is it an investment for securities. And the SIPC in that case said, perhaps understandably, because it's an industry funded organization and they don't want to pay out any more than they have to, they said it was cash.

The SEC disagreed and the Courts all the way up to the Second Circuit also disagreed. Said, no it's investment, even though they are fictitious securities, there was no such security at all, so it didn't fit into the statute. They said, no. These customers expected to have securities. But it was a hybrid decision, because they also said in foreshadowing the equity decision, you don't get the value of your fictitious securities.

So we think that this -- it's jump ball and really is the cost benefit analysis that Your Honor identified earlier. And again, just to return to the example, because the -- neither SIPA nor the trustee -- they stay a million miles away from this because they know there's no real response to it.

Customer A invests a $1 million in 1988 well within the time frame of this decade's long Ponzi scheme. Customer A chugs along and then near the end in 2008 when the scheme collapses, takes out $1,050,000. So Customer A is nominally in the trustee's nomenclature, a net winner to

the tune of $50,000.

Customer B is a very late investor. Customer B invests $1 million way back in 1988, but sometime in 2008. And then decides, gee, I need the money to buy a new mansion and takes out $950,000. Why we've just used these numbers (indiscernible - 00:38:14). No one would do that, but they put in $1 million and the next day they take out $950,000.

So again, using the trustee's nomenclature, Customer B is a net loser. They put in a million, they took out $950,000. So in the trustee's world, these people -- I have a net winner, you have a net loser. If this were a closed system, where these were the only two investors, the trustee's view is, well, we're going to sue that -- that bad net winner for $50,000 and we will give it to the net loser. And then it will be even Steven. They'll both have $1 million in and $1 million out.

But in the real world, that's not what happened. If you apply to those numbers -- and we do it in the brief and we're not using some fancy index. We're using the CPI all urban index that everyone agrees is a fair inflation measure. What really happens is that in 2008 dollars, constant dollars is recommended by the SEC, customer A really got back only $575,000. In other words, Customer A's real loss in the real world is 42 percent. Not -- he's not a net winner. He's actually a net loser. And Customer B --

compared to Customer B -- Customer B that's a simple arithmetical computation. That he or she is a 5 percent net loser.

So in the real world where real people live where government and businesses thrive and operate, Customer A is vastly more injured, vastly more harmed. And the fair thing is not to just put on blinders and pretend --

THE COURT: There are lots of customer Bs, Mr. Schwed who left all of their money and even put their money in in 2006, '07 --

MR. SCHWED: I don't know --

THE COURT: Your customer -- you don't know of others?

MR. SCHWED: I'm sorry, I'm not sure I understood your --

THE COURT: There are Customer Bs who never pulled anything out.

MR. SCHWED: Oh, there unquestionably are and no one is saying that Customer Bs should not be compensated. It's really a question of adjusting the numerator, the number that is the appropriate plain number to take into account unquestioned economic reality. And it's -- to do so, I think is just closing ones eye to the fairness.

THE COURT: You can always pick and choose a profile of a particular customer to almost validate any

mathematical argument that you might make in the whole Madoff scheme of things.

It's gone on for so many years and there are so many different kinds of fallout from whether you deal with constant dollar or whether you deal with the cash in/cash out.

MR. SCHWED: Well, Your Honor is no doubt --

THE COURT: Without any kind of adjustment.

MR. SCHWED: Well I think the only one that's been seriously proposed in the four and half years of this case is the adjustment to net investment method to account for -- apart from the 9 percent, which once again that's not our position. The only one that we have seen surface is the -- is to adjust for CPI, which is not a wild or outré idea. It's pretty standard concept that constant -- that inflation -- the ravages of inflation as Alexander Hamilton put it 200 years ago, are real. And that we shouldn't close our eyes to that. And in forging a judicially crafted remedy, that's the appropriate thing to do.

Thank you, Your Honor.

THE COURT: When you say it's the appropriate thing to do, Congress certainly knows how to deal with these kind of issues and maybe it's for Congress to determine.

MR. SCHWED: Well, Your Honor, that may be -- that often is the case, but I think in the absence of

Congressional action and again we don't think the SIPA statute, 78 LLL 11 the definition of net equity doesn't deal with this and given Congressional gridlock, they may never deal with it. It's incumbent upon the courts to try to do the right thing. And we are faced with real situation --

THE COURT: You want me to be a legislature.

MR. SCHWED: Pardon?

THE COURT: You want me to be a legislature.

MR. SCHWED: Well, I think in (indiscernible 00:42:36) legislature, I do think that that's what happens.

THE COURT: Okay. Thank you Mr. Schwed.

MR. SCHWED: Sure.

MR. KIRBY: Your Honor, I -- in response to the question that you just posed the issue is -- and that's what my colleague Mr. Schwed emphasized, this is not a case which is governed by the statute in with -- that the statute gives you the answer. That is the point of that -- the Second Circuit made in approving the net equity position saying that in this -- in a circumstance where you're applying a statute that says a customer claim for securities where there were no securities. There's a level of discretion that is built into the statute to the trustee.

And the trustee's method, which takes a cash amount in, but does not adjust that for inflation -- the standard that the Second Circuit said is that you have to

determine that's clearly inferior. And it is undisputed and the trustee does not dispute the basic fact that a 1985 or 1988 dollar is very different from a 2008 dollar.

And so that is the fundamental problem that is not solved by the statute and is left for the Court to deal with. That is the point that the SEC has reinforced here today.

MR. KIRBY: I'd like to just make two points because I don't want to belabor the comments of my colleagues. This is -- first, this is not an interest claim. That is a totally separate issue. We are not advocating for that. That's not an issue before the Court. There is -- other parties are here before the Court on that. We are not here on that point.

We are saying that when you looked at cash, and the cash in versus cash out, that cash determination, there needs to be an adjustment for inflation. The trustee abuses his discretion is he does not do that under the circumstances of this case. That's -- the Court has to address that issue.

I also would like to address the issue of Walsh because Walsh was an equity receivership, very different principles involved there. The different principle is is that you have a statute here that gives the customer in ordinary course a claim for securities. But the receiver

was not dealing with that.

The other significant difference between Walsh and this case is that there was one customer who supported an inflation adjustment. That was the appellant in Walsh. Here, you have an overwhelming number of customers who believe that an inflation adjustment is appropriate and that ought to be a significant difference.

The third thing is is that the level of discretion given an equity receiver to make a determination is not cabined by the situation that we have here where the Court has said that the way weight that is whether one is clearly inferior to the rest.

We think there's really no dispute that, and there can be no dispute, that using 1980 -- pretending that 1985 dollars should be valued as current dollars is a clearly inferior method.

Finally, I would like to address the issue of deference to the SEC that the -- that's an issue that was addressed both in the New Times case and the -- again, in the net equity case. They addressed the issue of deference to the position of the SEC on this.

The Court emphasizes that the issue is the power to persuade. And the power to persuade is -- what the SEC has said, and as I said reinforced here today, the same thing that we are saying -- that you cannot take dollars

that are 1985 or 88 dollars and measure those the same as if they -- your -- as if they were current dollars. That is something that is fundamental to basic economics and that is something that this Court should not ignore in determining the decision in this case.

Finally, I would address the issue of administrative burden because accepting that the record that has been made on that issue, there really can be no dispute, that implementing an inflation adjustment in today's world of excel spreadsheets and pushing a button and implementing across a database, it is a simple task. Mr. Rock testified in his deposition, and we put that into evidence before you, that it took him less than a $120,000 to implement an inflation adjustment that, using their method, across the entire database of the trustee's claims.

So, to suggest that for a minute that there is administratively burdensome to implement an inflation adjustment should the Court direct one is just -- there's no record support for it. And that's the reason, you know, we ask you to consider the testimony which you said you would with respect to Mr. Hart as submitted in his report.

THE COURT: I didn't say that I would. I said I would receive it into the record and I also stated, if I recall correctly or incorrectly, that I have my doubts under Daubert as to whether or not it would ultimately be accorded

sufficient weight to sway the Court one way or the other.

I also stated that the reason I'm doing this is I believe that this matter is determinable as a matter of law. So for purposes of all of you that want to make a record, I'm giving you your record.

But, again, I tell you it can be determined, and will be determined, as a matter of law.

MR. KIRBY: Thank you, Your Honor.

MR. SHEEHAN: I'll be very brief, Your Honor. Just two points --

THE COURT: It's not necessary. Everybody here is on the billing clock so they --

MR. SHEEHAN: Wow. Anyway, the quick points are these Your Honor.

With regard to the SEC, Mr. Avery was focusing on and there was some colloquy with Your Honor, with regard to this concerning the fact that the inflation adjustment should apply because this is securities as opposed to cash. Yet, if you look at the statute, when Congress looked at that, the colloquy you were having with Ms. Wang about this, and you look at the various provisions that are there, there is no inflation adjustment for securities. It's only for cash.

So if Congress was speaking to this issue, and wanted to do something about it, it had an opportunity to do

it. Not only did it not do it, it made a choice not to. So do -- for Mr. Avery to suggest that you engage in a little bit of legislative work here today, or Mr. Schwed actually said it, more so than Mr. Avery, yeah, the guidance that you would receive from Congress is is to not do that. Not to add an inflation adjustment to securities.

The other thing is Mr. Avery suggested that, you know, I'm confusing the principles of interest and inflation adjustment. I don't confuse them. I understand there are economic difference in the principles under girding both of those.

I tell you this; that to the net loser, the distinction is meaningless. To tell them that they got less money because it was an inflation adjustment, doesn't make it any fairer or easier for them to accept.

The other thing is --

THE COURT: Any of these theories result in an enhancement and to --

MR. SHEEHAN: Yes, exactly. And that's why, getting right to that, is that the suggestion by Mr. Schwed and Mr. Kirby that our position is inferior, that it should -- that they have a better -- Your Honor, ours is so consistent with net equity. It exactly follows net equity. I think the, quite frankly, even though the Second Circuit didn't address it, on purpose, we said so. It anticipated

where we are here today by suggesting that this is the only way to go. All right?

And while our -- my colleagues suggest that fairness and equity should somehow have play here, there's an old, time honored principle, that I think applies here. Equity follows the law. And the law here is is that there is no interest. And equity is also equality. And equality here means that everyone has to be treated the same. And the only way that happens is under the trustee's determination with regard to net equity.

Thank you, Your Honor.

THE COURT: Does anyone want to be heard? Sir.

UNIDENTIFIED SPEAKER: Please, go ahead.

MR. WARMUTH: Good morning, Your Honor. Glenn Warmuth for claimant, Michael Most.

Your Honor, Michael Most is not a trust or a feeder fund. He's just one man who invested and lost his money and he put in a claim. And we have two methods for -- competing methods for determining these claims; the net equity method and the time-based damages method, which takes into account the time value of money.

Now all that Mr. Most wants is to be treated fairly. And what I heard this morning from Mr. Sheehan is fair is not what is in play. Fair is not what is in play. And I would submit to the Court that a method which does not

take into account fairness is clearly inferior to a method which does take into account fairness. And that the time value of money takes into account fairness because Mr. Most invested his money early and his money is worth money. And that the claims should be adjusted so that that is accounted for.

Wherefore, I would ask that you respectfully deny the trustee's motion.

THE COURT: Thank you, sir.

MR. WARMUTH: Thank you.

MS. STEFANELLI: Good morning, Your Honor. Nicole Stefanelli of Lowenstein, Sandler on behalf of the irrevocable charitable remainder trust of Yell Fishman and the Glen Akeva (ph) Fishman charitable remainder uni-trust.

The trust filed an objection to this motion at docket number 5118.

Your Honor, quite honestly, we're a little bit puzzled as to why the trust's claims were listed on page 34 of Exhibit A to the declaration of Vic Cheema (ph). We do not believe that the trust's claims should be lumped in with the time-based damages and other claims here.

Briefly, Your Honor, in accordance with the procedures order that was entered back in December, December 23rd, 2008, the trusts filed objections to the trustee's determination letters, which were sent by the

trustee on April 27, 2010. Those objections were filed in May of 2010.

To date, the trustee has not sought a date and time for a hearing before this Court on the merits of those controverted claims in accordance with the procedures order. By this ---

THE COURT: I'm not dealing with claims objection. If you want to get to the point that's before the Court, the issue of time-value of damages as it applies to your client, I'll hear you. If not, everybody is entitled to some respite.

MS. STEFANELLI: Okay. Apologies, Your Honor. All we are asking is that the claim not be expunged as it's listed on Exhibit A. What we're really asking for is a hearing on the merits of our objection.

THE COURT: That's not the issue before me. Thank you.

MS. STEFANELLI: Thank you, Your Honor.

(Pause.)

MR. SCHWED: Just two very brief points. I was too hasty perhaps in --

THE COURT: Before you speak, Mr. Schwed, you and one of your colleagues, disassociated themselves from one of the methodologies and that is interest. I'm waiting to hear from the parties who are espousing a nine percent interest

rate.

I guess nobody really cares about that as a methodology. Go ahead, Mr. Schwed.

MR. SCHWED: I was perhaps too hasty in consenting to Your Honor's characterization of judicial legislation. I think, really, what we're talking about is a statute that doesn't deal with a situation. And that's really the task that I think courts deal with.

THE COURT: You should be reminded that today is a form of election day and I'm not running for any office.

(Laughter.)

MR. SCHWED: That's true indeed. I just wanted to address myself to one point made by Mr. Sheehan, again, in an attempt to show that the statute, in fact, deals with this issue, and he says that the statute provides for inflation adjustment -- for no inflation adjustment in the case of securities.

Well, of course, it doesn't. If you have securities, why would anybody every think of adding an inflation adjustment. That's really the point. If you get -- if the statute is framed as saying you get your securities back, why would Congress or a draft's person every say, you get your securities back plus interest. You get the -- any appreciation is embedded in the value of the security, plus or minus.

That was the only point I wanted to make.

THE COURT: Thank you. Does anyone else want to be heard? Very well.

I, again, want to express my appreciation for what I regard as very insightful, very high quality briefing. You've gotten together to pull resources before the Court and the submissions have been very welcome and enable me to come to the conclusion, as I expressed previously, that this is really determinable as a matter of law.

Broadly speaking, the trustee has determined that excluding time-based damages from the net equity calculus is appropriate because it's not only correct as a legal matter, but also assures that no customer is entitled to recover profits before other customers recover their principal investment. In contrast, the objecting claimants contend that the inclusion of time-based damages is more consistent with SIPA's protective aims and takes the economic reality of inflation into account by not arbitrarily penalizing early customers.

This Court recognizes that choosing any method for calculating net equity is particularly challenging in light of the complex and unique facts of Madoff's ponzi scheme and each suggested benefit method, I'm sorry, will benefit some victims at the expense of others. Indeed, in this zero-sum game where funds are limited, hard choices must be made.

The purpose, framework and distribution scheme of SIPA, as well as Second Circuit precedent, all support a method chosen by the trustee. Moreover, permitting the inclusion of time-based damages in the net equity calculus will likely have significant unintended consequences, including favoring certain investors who have already recovered their principal investments at the expense of other investors who have yet to recoup their principal and potentially providing a windfall for claims traders who never were victims of the Madoff fraud.

So, I'm granting the trustee's motion. I will issue a full opinion probably some time before the end of the day and in that regard, I do make a suggestion, as I did in connection with the net equity decision, that the parties consider a request or a motion to certify a direct appeal to the United States Court of Appeals for the Second Circuit.

I think in this particular case that's rather important because, as I know from prior activities before the Court, the trustee is holding in a security -- as security for ongoing litigation, and other purposes, some $4 billion. Mr. Sheehan, you can correct the amount --

MR. SHEEHAN: No, that's correct, Your Honor.

THE COURT: And out of that $4 billion, I think earmarked is some $1.4 billion on a net equity issue. So if that matter can be determined rather quickly, that's $1.4

billion that can go out rather quickly. I think the parties here should get together and determine whether or not they want to take that particular route.

And as I indicated, I will render the decision, probably some time before the end of the day. And if you want to hang out here for awhile, maybe I can do it within the hour.

(Chorus of thank you)

THE COURT: Thank you all.

(Proceedings concluded at 11:06 a.m.)

RULINGS

C E R T I F I C A T I O N

I, Jamie Gallagher, Melissa Looney and Pamela Skaw, certify that the foregoing transcript is a true and accurate record of the proceedings.

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